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July 29, 1998

Library Commission
San Francisco Public Library



Commissioners,

Attached is the City Librarian's annual report on the Fuhrman Trust Fund. The report summarizes the condition of the fund through the end of the prior fiscal year and provides an analysis of its future condition. The analysis is based on projections of revenue over the next two fiscal years and on budgeted expenditures. The report also contains recommendations on actions that we believe are necessary to ensure the integrity of the fund. I look forward to discussing this with you in more detail during your next meeting.

Regina Minudri

Regina Minudri
City Librarian

Attachment

Civic Center
San Francisco, California 94102

# STATUS OF THE FUHRMAN TRUST FUND

## ANNUAL REPORT

LIBRARY COMMISSION
SAN FRANCISCO PUBLIC LIBRARY

August 4, 1998

Regina Minudri, City Librarian
George M. Nichols, Chief Financial Officer

## I. INTRODUCTION

The Library Commission is a trustee for a charitable trust established in 1940 by Alfred Fuhrman. The trust was initially established for (1) the acquisition of books on economics and political science; and, (2) the adornment of Golden Gate Park. Upon acceptance of the bequest, the Board of Supervisors appointed the Library Commission and the Recreation and Park Commission as trustees of the fund. As trustees, the Library Commission and the Recreation and Parks Commission share a fiduciary responsibility to administer the terms of the Fuhrman Trust.

In 1993, at the direction of the Library Commission, the City Attorney requested the Probate Court to consider expanding the use of the Library's funds to include non-print forms of material related to economics and politics. The Court agreed and the trust language was modified.

The bequest included local real estate, which was sold many years ago, and oil-rich land located in Kern County. Until recently, this land was leased on a long-term basis to Shell Oil which paid royalties to the City for the oil it produced. The lease with Shell Oil, initiated in 1963, expired in March 1998. The lease was recently reassigned to ERA Energy and extended an additional 22 years – through the year 2020. In accordance with the terms of the trust, the revenue received from the lease is divided equally between the Library and the Recreation and Parks Department.

## II. ANALYSIS

### Current Condition

As of July 20, 1998, the Fuhrman Trust Fund (Fund) had reserves of approximately $4.3 million -- $1.5 million on deposit in an agency account for the San Francisco Public Library (SFPL) and $2.8 million in an agency account for the Recreation and Parks Department (RPD).[1] Although the current fund balance is substantial, royalty income which constitutes a significant portion of the annual revenues earned by the Fund, is in sharp decline. Moreover, as royalties decline and remaining reserves are drawn down to fund ongoing program, interest income earned by the Fund will also diminish.

### Fiscal Year 1997-98 Revenue

The Fund has two sources of income; (1) revenue from rents and concessions managed by the Department of Real Estate; and, (2) earnings from investments managed by the City Treasurer. In FY 1997-98, income from these sources totaled $680,000. These are described below.

*Rent and Concessions:* Revenue from rents and concessions consists primarily of royalties paid to the City by a private contractor for crude oil produced on 800 acres in Kern County. The land is owned by the City and royalty income from the oil is deposited into the Fund. In addition to royalties, a very small amount[2] is derived from two grazing leases. In FY 1997-98, rent and concession income totaled $383,000. In accordance with the terms of the trust, this amount was allocated equally to the agency accounts of the SFPL and the RPD. In FY 1997-98, earnings from rents and concessions comprised 56.4 percent of the $680,000 in revenue credited to the Fund.

Royalty income declined precipitously in FY 1997-98. According to data from the Department of Real Estate, in the two fiscal years proceeding FY 1997-98, income from this source averaged $549,000 per year. In comparison, $383,000 in royalty income was received in FY 1997-98 -- $166,000 or 30.2 percent less than the average over the preceding two years.

The decline which began in December 1997, continued at an accelerated pace through the end of the fiscal year. From December 1997, to June 1998, revenue dropped from $40,000 in December to $13,000 in June – a 67.5 percent decline in the amount received

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[1] The Fund consists of two agency accounts – one for the SFPL and one for RPD. The accounts are managed separately. The variance in account balances results from cumulative differences in amounts expended annually and differences in investment strategies employed by the two departments over the years.

[2] Grazing leases provide approximately $3,700 per year.

monthly over that period of time. Monthly royalty payments for FYs 1995-96 through 1997-98 are displayed on Attachment I. The decline in royalty income is attributable to:

1. The depletion of reserves in oil fields owned by the City. The field has been in production for over 50 years.

2. The increasing costs of pumping the remaining crude oil from the ground. The increased cost of operation has made this a less attractive and less profitable venture.

3. A lower grade of oil is being pumped which brings a lower price on the market.

The original lease between the City and Shell Oil Company was signed in 1963. This was a 35 year agreement that expired in March of 1998. The lease has since been extended and assigned to ERA Energy for an additional 22 years – through the year 2020. Although the lease has been extended and reassigned, the Department of Real Estate is unable to advise us on: (1) how much longer the oil fields will be in production; and (2) how much revenue will be generated from month to month.

***Investment Income:*** The Fund's reserve may be invested in two ways; (1) through a pooled money investment account; and/or, (2) a non-pooled investment account. Pooled investments represent a general investment strategy executed by the Treasurer on behalf of city departments funded by the General Fund. Non-pooled investments represent a specific investment strategy executed by the Treasurer at the request of departments with proprietary funds (non-General Fund) such as the Fuhrman Trust Fund. According to the Treasurer, non-pooled moneys are generally invested in short-term treasury bills and/or notes.

Although in the past, the Library has invested in non-pooled accounts, it did not do so in FY 1997-98; and, the Treasurer invested the Fund's reserves in the pooled money account. In FY 1997-98, pooled investments yielded approximately $297,000 – an estimated return of 6.9 percent. Of this amount, the SFPL and the RPD were apportioned $171,000 and $126,000, respectively.[3] Investment income comprised 43.6 percent of the $680,000 in revenue credited to the Fund in FY 1997-98.

**Projecting the Future Condition of the Fund: FY 1998-99 and Beyond**

Given the factors described above, it is clear that royalty income is a declining source of revenue. Moreover, it is reasonable to assume that at some point in the not too distant future, this enterprise will cease to be cost-effective and that royalty payments will end.

[3] The reasons for the variance in how interest was credited are not known at this time. The data suggests that the SFPL earned interest at a rate of 10.9 percent; while, the RPD's rate of return was 4.6 percent. Controller advises that the average rate of return on pooled investments is approximately 6 percent.

With the information available, predicting when this will occur is not possible. However, for short-term budget planning (1 to 3 years), we can make assumptions regarding revenue and expenditures that can inform long-term decision-making.

Attachment II, is a balance sheet for the Fund. It displays the Fund's assets, liabilities, and equity. Attachments III and IV, contain an analysis of the Fund. The analysis covers FYs 1997-98 through 1999-00. Attachment III, provides detail on reserves, revenue, and expenditures for both the SPFL and the RPD. Attachment IV, displays the same detail for the SFPL.

The analysis is based on prior year (FY 1997-98) carry-forward balances, revenue, and expenditures;[4] and, on assumptions regarding FY 1998-99 and 1999-00 revenue and expenditures. The assumptions used in analyzing or projecting the future condition of the Fund are:

1. Interest earnings from investments are calculated at 6 percent of the available balance in each agency account. The Controller advises that for planning purposes, 6 percent is appropriate. This analysis does not assume that earnings will be apportioned to the SFPL and the RPD on the same ratio that they were apportioned in FY 1997-98.

2. Total income from rents and concessions (royalties) will generate $12,000 per month or $144,000 per year in FYs 1998-99 and 1999-00. This revenue will be apportioned equally to the SFPL and the RPD. Projected revenue is significantly less than the $40,000 to $50,000 per month received in the two years prior to FY 1997-98; and, less than the average monthly amount ($18,466) received from January 1998 through June 1998. As indicated previously, the Department of Real Estate is unable to project how much longer the wells will be productive. They have however, advised us to be cautious in our projections of this revenue[5]. The projection used in this analysis is consistent with that advice.

3. In the current fiscal year (1998-99) $325,000 is appropriated to the SFPL from the Fund. This analysis assumes that this amount will be fully spent. The analysis also assumes that a like amount will be appropriated and spent in FY 1999-00.

## Findings and Recommendations

Since its inception, the Fund has provided the SFPL with a significant source of funding to build and enhance its collection of economics and political science material. Over the years, the SFPL has spent in excess of $3.9 million from the Fuhrman Funds on this material.

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[4] As recorded in the City's Financial Accounting Management Information System (FAMIS). This is the City's online budget and accounting system.

[5] Revenue for July 1998 was $11,071.

Based on this analysis, it is clear that spending at current budgeted levels will quickly deplete the Fund's reserves. As shown in this analysis, expenditures will exceed projected revenue in FYs 1998-99 and 1999-00, by 97.4 percent and 109.7 percent, respectively. The major findings of this analysis and report are summarized below.

1. ***The Fund is currently solvent.*** As of the end of FY 1997-98, the SFPL agency account had an uncommitted balance of $1.5 million.

2. ***Royalty revenue is declining rapidly.*** Royalty income received in FY 1997-98 declined 30.2 percent from the average amount received in FYs 1995-96 and 1996-97. The Department of Real Estate (DRE) advises that monthly revenue may average only $10,000 to $12,000 per month in FY 1998-99. DRE cannot project how much longer wells will be productive or monthly royalty income.

3. ***Interest income may be overstated in FY 1997-98.*** Data suggests a return of 10.9 percent. According to the Controller, pooled money accounts earned on average 6 percent in FY 1997-98. Interest credited to the SFPL may be overstated based on the method used by Controller to apportion funds between the SFPL and RPD.

4. ***Fund cannot support annual expenditures of $325,000 as is currently budgeted.*** Based on revenue assumptions; expenditures will exceed revenue by almost 100 percent in FY 1998-99; and, by more than 100 percent in FY 1999-00. Spending at budgeted levels will result in a 21.4 percent reduction in anticipated reserves over the three year period.

If managed properly, the Fund can continue as a viable source of supplemental funding to maintain and enhance this collection. This will require the SFPL to bring expenditures in-line with anticipated or projected revenue, closely monitor royalty income, and to invest reserve funds in a way that ensures the best rate of return.

Given the existing circumstances, the following recommendations are put forth for consideration by the Commission.

1. ***Limit FY 1998-99 expenditures to $150,000.*** If additional revenue materializes, expenditures could be increased. Depending on the amount of additional revenue, current year expenditures could be increased somewhat. Limiting current year expenditures to $150,000 (or less) will ensure that expenditures do not exceed anticipated income; and, increases the year-end balance available for investing.

2. ***Reduce budgeted expenditures in FY 1999-00 from the current authorized level of $325,000 to $150,000.*** Reducing the budget to $150,000 (or less) will ensure that

expenditures do not exceed anticipated income; and, increases the year-end balance available for investing.

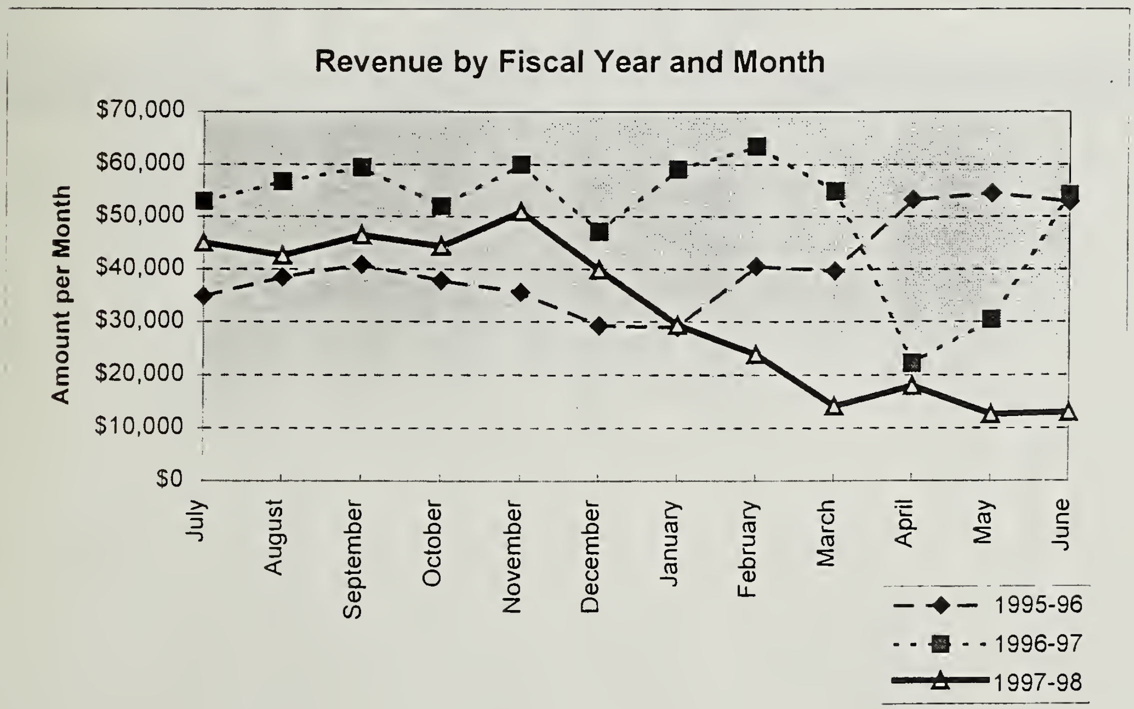
3. ***Pursue a more aggressive investment strategy with the Treasurer's Office.*** Currently, all reserves are invested in pooled accounts. Direct the Treasurer to invest a portion of the reserve in non-pooled accounts, if this strategy results in a higher yield.

4. ***Closely monitor royalty income.*** Adjust current year and budget year expenditures accordingly.

FUHRMAN TRUST FUND
ROYALTY REVENUE BY FISCAL YEAR



| | 1995-96 | 1996-97 | 1997-98 |
|---|---|---|---|
| July | $34,868 | $52,869 | $45,007 |
| August | $38,484 | $56,701 | $42,566 |
| September | $40,836 | $59,381 | $46,463 |
| October | $37,810 | $51,952 | $44,351 |
| November | $35,595 | $59,918 | $50,920 |
| December | $29,296 | $47,123 | $39,777 |
| January | $28,944 | $59,016 | $29,349 |
| February | $40,560 | $63,416 | $23,839 |
| March | $39,638 | $54,862 | $14,100 |
| April | $53,258 | $22,181 | $17,942 |
| May | $54,490 | $30,415 | $12,600 |
| June | $52,820 | $54,124 | $12,969 |
| ***Total*** | ***$486,599*** | ***$611,958*** | ***$379,883*** |
| Average/Month | $40,550 | $50,997 | $31,657 |



# COMBINING BALANCE SHEET

| | SFPL | RPD | TOTAL |
|---|---|---|---|
| **ASSETS** | | | |
| Deposits and Investments | $1,530,324 | $2,874,475 | $4,404,799 |
| Interest and Other Receivables | $13,479 | $21,132 | $34,611 |
| **Total Assets** | **$1,543,803** | **$2,895,607** | **$4,439,410** |
| **LIABILITIES** | | | |
| Accounts Payable | $9,028 | $0 | $9,028 |
| **Total Liabilities** | **$9,028** | **$0** | **$9,028** |
| **FUND EQUITY** | | | |
| Reserve for Appropriation Carryforward | $971,896 | -$46,238 | $925,658 |
| Unrealized Estimated Sources | $264,568 | $113,375 | $377,943 |
| Unreserved Balance - Available for Appropriation | $298,310 | $2,828,470 | $3,126,780 |
| **Total, Fund Equity** | **$1,534,774** | **$2,895,607** | **$4,430,381** |
| **Total Liabilities and Fund Equity** | **$1,543,802** | **$2,895,607** | **$4,439,409** |

# DETAILED FUND CONDITION STATEMENT
## FUHRMAN BEQUEST FUND

| | ACTUALS | | | PROJECTED | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1997-98 | | | 1998-99 | | | 1999-00 | | |
| | SFPL | RPD | Total | SFPL | RPD | Total | SFPL | RPD | Total |
| BALANCE (Carried Forward from Previous Year | $1,553,134 | $2,706,547 | $4,259,681 | $1,543,802 | $2,895,607 | $4,439,409 | $1,383,430 | $2,937,343 | $4,320,774 |
| Prior Year Adjustments (Revenue/Expenditures) | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| **Adjusted Balance** | $1,553,134 | $2,706,547 | $4,259,681 | $1,543,802 | $2,895,607 | $4,439,409 | $1,383,430 | $2,937,343 | $4,320,774 |
| **REVENUE** | | | | | | | | | |
| Interest & Investments | $170,782 | $125,901 | $296,683 | $92,628 | $173,736 | $266,365 | $83,006 | $176,241 | $259,246 |
| Rents & Concessions | $191,420 | $191,420 | $382,840 | $72,000 | $72,000 | $144,000 | $72,000 | $72,000 | $144,000 |
| Other | | | $0 | | | $0 | | | $0 |
| **Total Revenue** | **$362,202** | **$317,321** | **$679,523** | **$164,628** | **$245,736** | **$410,365** | **$155,006** | **$248,241** | **$403,246** |
| **TOTAL RESOURCES AVAILABLE** | **$1,915,336** | **$3,023,868** | **$4,939,204** | **$1,708,430** | **$3,141,343** | **$4,849,774** | **$1,538,436** | **$3,185,584** | **$4,724,020** |
| **EXPENDITURES (Appropriations)** | **$371,534** | **$128,261** | **$499,795** | **$325,000** | **$204,000** | **$529,000** | **$325,000** | **$204,000** | **$529,000** |
| **BALANCE** | **$1,543,802** | **$2,895,607** | **$4,439,409** | **$1,383,430** | **$2,937,343** | **$4,320,774** | **$1,213,436** | **$2,981,584** | **$4,195,020** |
| **Ratio of Expenditures to Revenue** | 102.6% | 40.4% | 73.6% | 197.4% | 83.0% | 128.9% | 209.7% | 82.2% | 131.2% |
| **Change in Year-End Balance** | | | | -10.4% | 1.4% | -2.7% | -21.4% | 3.0% | -5.5% |

**NOTES:**

1) FY 1997-98 data from FAMIS as of July 20, 1998.

2) FY's 1998-99 and 1999-00 amounts estimated from information obtained from the Department of Real Estate and the City Treasurer's Office.

3) This analysis assumes revenue from "Rents and Concessions" at $12,000 per month for FYs 1998-99 and 199-00.

4) Earnings from "Interest & Investments" calculated at 6 percent of the beginning balances for both FYs 1998-99 and 1999-00.

**FUND CONDITION STATEMENT**
FUHRMAN TRUST FUND
San Francisco Public Library

| | ACTUALS | PROJECTED | |
|---|---|---|---|
| | 1997-98 | 1998-99 | 1999-00 |
| **BALANCE (Carried Forward from Previous Year)** | **$1,553,134** | **$1,543,802** | **$1,383,430** |
| Prior Year Adjustments (Revenue/Expenditures) | $0 | $0 | $0 |
| **Adjusted Balance** | $1,553,134 | $1,543,802 | $1,383,430 |
| **REVENUE** | | | |
| Interest & Investments | $170,782 | $92,628 | $83,006 |
| Rents & Concessions | $191,420 | $72,000 | $72,000 |
| Other | $0 | $0 | $0 |
| **Total Revenue** | $362,202 | $164,628 | $155,006 |
| **TOTAL RESOURCES AVAILABLE** | $1,915,336 | $1,708,430 | $1,538,436 |
| **EXPENDITURES (Appropriations)** | $371,534 | $325,000 | $325,000 |
| **BALANCE** | **$1,543,802** | **$1,383,430** | **$1,213,436** |
| Ratio of Expenditures to Revenue | 102.6% | 197.4% | 209.7% |
| Change in Year-end Balance | | -10.4% | -21.4% |

NOTE: All amounts derived from FAMIS and are current as of 7/20/98. FY's 1998-99 and 1999-00 are estimated.